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Comments on OECD Trade Committee Working Paper
on the Economic Situation and Prospects in the GDR.
(TC/WP(84)46)

The Secretariat has done a good job in addressing a difficult subject. Chapter III on the debt situation is particularly well done. The Office of European Analysis of CIA offers the following general comments and suggestions for specific changes.

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-- Our assessment of the prospects for the East German economy is somewhat more optimistic than the Secretariat's. We believe that the East German economy still faces serious problems, but that the country has made considerable progress in the last few years in improving both its external accounts and the efficiency of the domestic economy. We believe the Honecker regime has boosted the priority of exports and made hard currency trade surpluses a key objective. We expect that it will continue to run surpluses and that its efforts to change the structure of the economy will enable East Germany to grow relatively rapidly, by East European standards, over the next few years.

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-- The paper does not take sufficient account of the tactics employed by the East Germans in 1982-83 in their struggle to avoid a financial crisis. It does not fully note the deliberate East German shifts in their trade in order to improve the balance of payments picture.

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Specifically, the East Germans stepped up imports from West Germany and routed some imports from third countries through the FRG, while boosting exports to Western countries other than the FRG. This gained the GDR a short term hard currency trade improvement, while increasing the clearing account deficit with West Germany. Since late 1983, as its financial pinch eased, East Germany has been able to move its trade with the FRG into surplus. []

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- The authors correctly note the lack of East German economic data and the extreme secretiveness of the Honecker regime. East Berlin consistently has resisted Western banker requests for additional data, and has released selected statistics only periodically, typically when they portray East German performance favorably. []

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Comments on individual paragraphs follow. []

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Paragraph 1. We believe that there is considerable internal debate over economic policy and that much of it is pragmatic and not "ideologically orthodox." The GDR's devotion to secrecy and discipline precludes public debate and creates a false impression of unanimity. []

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Paragraphs 10-11, 12-15. The paper correctly describes the importance of the USSR to East Germany, and the GDR's role within CEMA. We believe it might be useful to add that Soviet leaders (such as Premier Tikhonov last year in East Berlin) have indicated that the USSR wants more and better quality goods in return for its deliveries of raw materials and energy. A significant toughening of Moscow's trade terms for the next five year planning period (1986-90) could hurt East Berlin's economic prospects markedly.

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Paragraphs 14, 70, 88, 93, 99, 104. We have some problems with the analysis of the GDR's oil trade policies. In our view, the paper is mistaken when it asserts that the East Germans are refining and reselling Soviet-origin oil. Moreover, East Germany's policy of exporting petroleum products makes good sense if, as we believe:

1. The bulk of the exported oil has been procured largely through barter or near-barter from OPEC countries, while sales to Western Europe are for hard currency.
2. Such sales utilize existing refining capacity and provide the East Germans a profitable return on their "value-added."
3. Refined products sold to West Berlin are at an above-market price because of a special agreement.

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Paragraphs 19-20. Our estimate of year-end 1982 hard currency debt is somewhat higher than the paper's and our estimate of debt service somewhat lower, but data problems make any such estimate difficult. We do not propose a change.

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Paragraph 23. We have revised our method for estimating the GNP of the East European countries. Our new approach results in a downward revision of figures for the "richer" countries and an upward revision for the "poorer" ones. We now estimate East German per capita GNP in 1983 at \$9295 (1983 US dollars)--38 percent over the average for the East European Warsaw Pact countries. Our preliminary estimate is that GNP grew by two percent in 1983, compared with no growth in 1982 and two percent in 1981. The paper correctly cites the official East German figure for national income growth in 1983 of 4.4 percent.

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Paragraphs 28, 29. As the paper correctly states, the regime's stable retail price index is unrealistic in the face of clear evidence that consumer prices have risen significantly. We believe that real personal consumption declined somewhat in 1982 and, at best, stagnated in 1983. While these results compare favorably to some other East European countries, they represent a significant departure from the steady rise in personal consumption during the 1970s.

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Paragraph 30. The GDR is increasingly exploiting its plentiful supplies of lignite. Production in 1982 was 276 million metric tons. The regime announced that lignite provided 71 percent of primary energy consumption in 1983--up from 54 percent in 1980--higher than the domestically provided energy share of many OECD countries.

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Paragraph 40. The government also has accelerated electrification of the country's rail system, thus using electricity generated by domestically produced lignite while saving diesel fuel.

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Paragraph 61. In recent years, because of Poland's economic problems, Hungary has become East Germany's second largest East European trading partner.

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Paragraph 66. We have no evidence that East Germany is trying to replace Western firms as suppliers of technology to CEMA countries. The GDR itself relies heavily on imports of technology from the West. Moreover, much of its emphasis on "microelectronics" is designed to improve the efficiency of the domestic economy, not to enhance its position within CEMA.

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Paragraph 71. Our estimate of the accumulated trade deficits with nonsocialist countries for 1970-80 is significantly above \$11.7 billion. The Secretariat might wish to investigate this matter further.

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Paragraph 72. The last sentence should read "...was partly offset by an increase in imports (instead of exports) from the Federal Republic..." []

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Paragraph 73. Our estimate of the GDR's deficit in 1980 is close to the Secretariat's. In 1982, however, our estimate is very close to the official figure of a \$1.5 billion trade surplus compared with the paper's \$800 million estimate. []

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Paragraph 74. Hungary appears the most interested of all the CEMA countries in boosting economic ties with the West. While not "switching" to CEMA, East German figures show that the Soviet share of their trade was 38 percent in 1982, up from 36 percent in 1980 and 31 percent in 1974. []

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Paragraphs 77, 84. The GDR uses different accounting standards than most Western countries leading to different results for East German trade by share. East German statistics for 1982 show the FRG plus West Berlin's with 30.7 percent of the GDR's trade with "industrialized capitalist" countries, 25.4 percent of trade with nonsocialist countries, and 8.6 percent of overall trade. []

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Paragraph 80. We would add that most intra-German trade is conducted through clearing account using a "unit of account" or Verrechnungseinheit (VE), which is defined as equal in value to the DM, but which cannot be converted into DM. []

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Paragraph 88. While OECD countries' "alarm" at large deficits with East Germany is understandable, the Secretariat's

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assertion that the GDR's improved trade balance may be "transitory" seems too strong. The East Germans may well elect to run smaller current account surpluses as their debt declines, but a return to the chronic deficits of the 1970s appears very unlikely.

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Paragraph 106. We are unaware of East German publication of current account statistics, but our estimate of the current account improvement in 1979-82 is similar to that attributed to the East Germans.

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Paragraph 107. The Secretariat's comment that "any deficit (on intra-German trade) is covered by a swing credit" is incorrect. Because the swing is in effect an interest-free FRG loan to the GDR, the East Germans use it regardless of their trade balance. For example, the East Germans retained a sizeable deficit on the swing account in 1980-82 despite trade surpluses with West Germany. Moreover, since the swing is kept near its ceiling by the East Germans, chronic deficits with the FRG--such as in the 1970s--cannot be accommodated by the swing credit.

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Paragraph 109. The Secretariat's analysis that there is "no hope of any substantial increase in the GDR's sales to the OECD countries" seems unduly pessimistic, and at odds with some of its previous comments. East Germany has problems with the competitiveness of its products, but seems determined to boost exports to the West.

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